

STATE OF WISCONSIN

SENATE CHAIR
TIM WEEDEN

LL1, 119 Martin Luther King Jr. Blvd.
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ASSEMBLY CHAIR
BEN BRANCEL

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JOINT COMMITTEE ON FINANCE

MEMORANDUM

TO: Members, Joint Committee on Finance

FROM: Representative Ben Brancel
Senator Tim Weeden
Co-Chairs, Joint Committee on Finance

DATE: April 8, 1996

RE: 16.505/515 (2) Request

Attached is a copy of a request from the Department of Administration dated April 5, 1996 pursuant to 16.505/515 (2) pertaining to requests from the Educational Approval Board, the Public Service Commission and the State of Wisconsin Investment Board.

Please review these items and notify Representative Brancel's office not later than Wednesday, April 24, 1996 if you have any concerns about the request or would like the committee to meet formally to consider it.

Also, please contact us if you need further information.

BB:TW:kc

CORRESPONDENCE MEMORANDUM

STATE OF WISCONSIN
Department of Administration

Date: April 5, 1996

To: The Honorable Tim Weeden, Co-Chair
Joint Committee on Finance

The Honorable Ben Brancel, Co-Chair
Joint Committee on Finance

From: James R. Klauser, Secretary
Department of Administration

Subject: S. 16.515/16.505(2) Requests

Enclosed are requests which have been approved by this department under the authority granted in s. 16.515 and s. 16.505(2). The explanation for each request is included in the attached materials. Listed below is a summary of each item:

<u>AGENCY</u>	<u>DESCRIPTION</u>	<u>1995-96</u> <u>AMOUNT</u>	<u>FTE</u>	<u>1996-97</u> <u>AMOUNT</u>	<u>FTE</u>
EAB 20.292(2)(g)	Proprietary School Programs	\$20,000		\$20,000	
PSC 20.155(1)(j)	Intervenor Financing	\$185,000			
PSC 20.855(6)(i)	Miscellaneous Program Revenue; Universal Service Fund	\$3,420,000		\$8,000,000	
SWIB 20.536(1)(k)	General Program Operations	\$122,900	7.00	\$492,900	7.00

As provided in s. 16.515, this request will be approved on April 26, 1996, unless we are notified prior to that time that the Joint Committee on Finance wishes to meet in formal session about this request.

Please contact Linda Nelson at 266-3330, or the analyst who reviewed the request in the Division of Executive Budget and Finance, if you have any additional questions.

Attachments

CORRESPONDENCE MEMORANDUMSTATE OF WISCONSIN
Department of Administration

Date: March 18, 1996

To: James R. Klauser, Secretary
Department of Administration

From: Michelle New
State Budget Office

Subject: Request Under s. 16.505/16.515 from the State of Wisconsin Investment Board for risk management resource needs.

REQUEST:

The State Investment Board requests approval of an additional 8.0 FTE positions and supplementary expenditure authority of \$135,900 PR in FY96 and \$531,600 PR in FY97.

REVENUE SOURCES FOR APPROPRIATION:

This request would be funded from the s. 20.536 (1)(k), general program operations appropriation. Revenues to this appropriation are procured from charges to each of the trust funds managed by SWIB, based on the actual costs to manage each fund.

BACKGROUND:

The State Investment Board currently employs 85.5 individuals, an increase of 4 FTE over the last biennium.

SWIB manages slightly over \$40 billion in assets. The trust funds of the Wisconsin Retirement System account for 91% of funds managed, the State Investment Fund represents 8%, and all other funds account for the remaining 1%. SWIB's assets have increased dramatically over the past ten years as indicated below. As the assets under management have increased, the risk of managing the funds has increased commensurably.

Total Assets Under Management

<u>Fiscal Year</u>	<u>At Year End</u>	<u>Average Over Year</u>	<u>Percent Increase</u>
1986	\$15,250,647,000	\$13,798,813,000	
1987	17,978,744,000	16,614,695,500	20.4%
1988	18,239,473,000	18,109,108,500	9.0%
1989	21,123,360,000	19,681,416,500	8.7%
1990	23,380,847,000	22,252,103,500	13.1%
1991	25,680,415,000	24,530,631,000	10.2%
1992	29,186,270,000	27,433,342,500	11.8%
1993	33,334,618,000	31,260,444,000	14.0%
1994	34,469,000,000	33,901,809,000	8.4%
1995	37,809,000,000	36,139,000,000	6.6%
1996 Est.	42,700,000,000	40,254,500,000	11.4%
1997 Est.	45,902,500,000	44,301,250,000	10.1%

The Investment Board's request emanates from three distinct studies: (1) a Legislative Audit examination of the investment practices of the board, (2) an independent consulting report by Price Waterhouse and (3) an internal staffing examination.

In July 1995, the Legislative Audit Bureau examined in detail the investment practices of the Board. Their report concluded that the substantial investment losses incurred during FY 1995 were due to both excessive risk-taking and weak internal management controls. The LAB indicated a need for additional staff to improve management controls. In part, these were addressed in SB 402. This legislation provided 7 additional positions along with increased expenditure authority of \$310,600 in FY 1995-96 and \$582,000 in FY 1997. SB 402 did not provide all the resources needed for managing investment risk.

The second study was conducted independently by Price Waterhouse. In their final report, Price Waterhouse suggested SWIB implement more consistent measurement techniques for the detection of risk. Methods proposed included the formation of additional Board committees, increased management reporting, and enhanced clarification of general investment guidelines and practices.

These reports prompted SWIB to undertake its own comprehensive internal staffing examination. Their internal study spanned each of SWIB's investment groups and endorsed the creation of several new positions to meet the recommendations as outlined in the above two reports.

ANALYSIS:

Since the derivative losses in 1995, SWIB has focused its attention on the policies, organizational structure and resources needed to adequately manage risk, as encouraged by the Legislative Audit Bureau. This 16.505/515 request is the result of an internal study conducted over several months which reviewed both staffing patterns and overall workload.

The position requests can be divided into four categories:

I. Risk management.

- Quantitative Investment and Risk Analyst (2.0 positions requested \$30,600 FY96, \$109,600 FY97).

While most of the immediate needs to improve management controls were addressed in SB 402, a few needs identified by the LAB were not covered in the legislation. These positions all fall under the risk management category. As referenced in LAB #95-16, these 2 positions would be utilized in the Investment Analytics Group to perform analysis of risk, performance and asset allocation for the chief investment officer. Along with the chief investment officer, this staff of analysts would increase overall investment oversight.

II. Public fixed income.

- Public Fixed Income Credit Analyst (1 position requested \$15,300 FY96 and \$58,800 FY97).

Currently, the Investment Board reviews the credit-worthiness of borrowers in the bond markets about every 18 months. This position would be used to shorten the credit review cycle from 18 to 12 months. It would also expand SWIB's coverage of new companies and industries for bond portfolio consideration. The public fixed income credit analyst would be in addition to 4 other FTE analysts in the Public Fixed Income Division. While this Division already carries a high proportion of analysts, increased reporting may be advantageous from a risk reducing strategy for SWIB.

III Analytical support and back-up in the investment divisions.

- Domestic Equities Assistant Portfolio Manager (3.0 positions requested \$62,000 FY96, \$274,300 FY97).

The Domestic Equities Division currently is comprised of 3 Investment Directors, 8 FTE Analysts and 4 additional FTE positions. It is the largest division within SWIB. The three portfolio managers would assist in the development and execution of strategies, and monitor trading activity and price movements. Positions would also provide continuity and short term back-up for the portfolio managers. They would reduce the management risk associated with staff departures.

IV. Reporting and oversight.

- Investment Policy and Information Specialist (1.0 position requested, \$14,800 FY96, \$50,200 FY97).

This position would provide expanded reports to the Legislature and additional information to beneficiaries and the public. An investment policy and information specialist would assume a lead role in the preparation of an expanded annual report and other informational materials. The position would also play a lead role in staffing the toll-free interactive voice response information line for fund participants.

- Paralegal (1.0 position requested, \$13,000 in FY96 and \$38,700 in FY97).

The paralegal position would support the increased workload associated with minutes and proceedings of new Board and staff committees, outside counsel, and increases in compliance reporting requirements.

TOTAL REQUESTED RESOURCE NEEDS: \$667,500 (\$135,900 FY96, \$531,600 FY97).

The Investment Board's operating budget has increased dramatically over this biennium. While the Board's holdings have also increased dramatically since FY95, much of the gain has come from appreciation of holdings, rather than a substantial increase in the number of transactions. 1995 Act 27 gave SWIB an operating budget of \$7,392,000 in FY97. The FY97 budget was increased by SB 402 by another \$532,900. If approved in its entirety, this 16.505/515 request would increase FY97 spending authority by an additional \$531,600. These funding issues and staffing increases are compared to the 1995 adjusted base below:

	<u>FY 1996</u>		<u>FY 1997</u>	
	<u>Funding</u>	<u>Positions</u>	<u>Funding</u>	<u>Positions</u>
Adjusted Base	\$7,542,400	79.5	\$7,542,400	79.5
Act 27	+329,600	+4.0	+389,600	+4.0
SB 402	+178,400	+7.0	+532,900	+7.0
16.505/515	<u>+135,900</u>	<u>+8.0</u>	<u>+531,600</u>	<u>+8.0</u>
TOTAL	\$8,186,300	98.5	\$8,996,500	98.5
Percent Change (over base)	8.5%	24%	19.3%	24%

RECOMMENDATION:

S. 16.515 provides for supplemental expenditure authority if an appropriation becomes insufficient as a result of an unforeseen emergency. The derivative losses in FY95 proved to be unanticipated and created the need to conduct continuing risk assessments of Investment Board holdings. As the assets have expanded and as investment vehicles have become more diverse and complex, the ongoing need for risk assessment has become more acute. Given the size of the portfolios at risk, action on the risk sensitive aspects of the request is prudent and should not be deferred to the next biennial budget.

To provide adequate risk assessment, partially approve the request as follows:

Risk management. Approve the Quantitative Investment and Risk Analyst positions. They are in keeping with the Audit Bureau's findings.

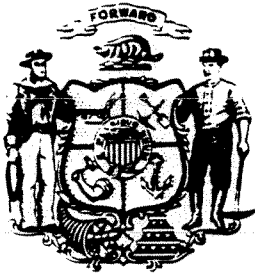
Public fixed income. Approve the fixed income credit analyst position. The Investment Board's bond holdings total approximately \$6.4 billion. With this amount at risk, the review of credit-worthiness and new company offerings should be expanded. An eighteen month review cycle is too long under current market conditions.

Analytical support and back-up in the investment divisions. Approve 3.0 assistant portfolio managers. The Domestic Equities Group manages three portfolios which each include up to \$5.0 billion in assets. There currently are no assistant managers in this division. These positions will reduce risk during a portfolio manager's absence. Assistant portfolio managers will help in the assessment of risk associated with potential transactions, and provide a separate perspective on the market.

Reporting and oversight. This category contains two distinct position groupings. The paralegal would be used in conjunction with the increased reporting requirements and the investment policy and information specialist would be used internally in helping to prepare the expanded, detailed reports as requested by both the Legislature and the Legislative Audit Bureau. The investment policy and information specialist should be approved. The need to communicate accurate and timely information about SWIB to the legislature and the public is imperative. This position would also be used to help research and evaluate new programs to improve the quality of information provided to all interested parties. Finally, because the paralegal position is not directly tied to immediate risk management needs, a decision on this request can be deferred until the next biennial budget.

Summary of funding and position recommendations.

<u>Position</u>	<u>Status</u>	<u>FY96</u>	<u>FY97</u>
Assistant Portfolio Managers	Approve 3	\$62,200	\$274,300
Public Fixed Inc. Credit Analyst	Approve 1	\$15,300	\$58,800
Quantitative Inv/Risk Analyst	Approve 2	\$30,600	\$109,600
Paralegal	Not Approve		
Inv. Policy and Info. Specialist	Approve 1	\$14,800	\$50,200
TOTAL	7 FTE Positions	\$122,900	\$492,900



STATE OF WISCONSIN INVESTMENT BOARD

MAILING ADDRESS:
P.O. BOX 7842
MADISON, WI 53707

121 EAST WILSON ST.
MADISON, WI 53702
(608) 266-2381

February 27, 1996

Mr. James R. Klauser, Secretary
Department of Administration
101 East Wilson
Madison, WI 53707

Re: ss. 16.505/515 Request for Risk Management Resource Needs

Dear Secretary Klauser:

The Investment Board (SWIB) is submitting the following request for approval under ss. 16.505/515 of the Statutes to address immediate risk management resource needs.

Summary of Request

Over the last year, SWIB Trustees and staff have focused a great deal of attention on the policies, organizational structure and resources which are needed to effectively manage risk and earn favorable rates of return for fund participants. Significant steps have been taken:

- The Trustees have created two new committees of the Board (Audit and Investment Policy) to focus greater attention on risk management.
- A staff Risk Management Committee has been established to review derivative transactions and all new investment initiatives.
- More restrictive investment guidelines have been adopted for use of derivative investments.
- Reports to the Trustees have been improved to better highlight risk at the portfolio and fund levels. A strategic information systems plan is being developed in order to further integrate and improve the reporting and monitoring of investment risk.

Several organizational changes are planned at the senior management level which will further strengthen oversight. A chief operating officer will be added, through internal reallocation of an existing position, to oversee a number of critical business functions. A chief investment officer, internal auditor and several support staff are provided in the Joint Audit Committee's legislation (SB 402/AB 664) which is awaiting final legislative action (see Attachment A). Our December 22, 1995 report to the Joint Audit Committee (Attachment E) describes these and other efforts in greater detail.

The Legislature has affirmed that SWIB should continue to emphasize internal management of assets. Total assets under management surpassed \$40 billion in 1995. SWIB manages the ninth largest public pension fund in the U.S. Our growing size and the increasing complexity of our activities require that

Secretary Klauser
February 27, 1996
Page 2

we address other resource needs to continue to do the job effectively. As the Joint Audit Committee developed SB 402/AB 664, we noted that there were other personnel needs which required attention. We were advised by the Co-Chairs of the Joint Audit and Joint Finance Committees to address other immediate needs through the ss. 16.505/515 process.

Our request is the result of a comprehensive review of staffing patterns and workload which spanned several months. The purpose of this exercise was to determine where there may be risk due to inadequate analytical support or back-up in our investment divisions. Support areas were reviewed to determine whether they are adequately staffed to meet additional reporting and oversight responsibilities which are being implemented. Recent reports by the Legislative Audit Bureau and Price Waterhouse concerning risk management issues were helpful in this process.

As a result of this review, we are requesting approval for 8.0 PR positions, effective May 1, 1996, and additional expenditure authority of \$135,900 PR in FY 1996 and \$531,600 PR in FY 1997. Attachment B summarizes our request. A more detailed description of the responsibilities and justification for each position follows in Attachment C.

The first three items in the request [the domestic equities assistant portfolio managers and public fixed income credit analyst] reflect immediate needs for stronger analytical support and back-up in the investment divisions. The second group of items [the quantitative risk analysts, investment policy and information specialist, and paralegal] addresses reporting and oversight concerns.

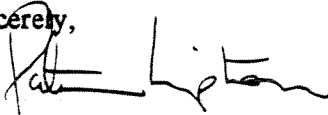
This request is critical to our ability to go forward on several key risk management measures. Even with the additional resources provided in this request, our operating budget as a percentage of assets under management will remain under 2.1 basis points (see Attachment D). SWIB's operating costs will also remain far below those experienced by pension funds which primarily rely on outside management.

Revenue Sources for Appropriation

This request will be funded from the appropriation under s. 20.536 (1)(k). Revenues to this appropriation are generated from charges to the trust funds managed by SWIB, based on our actual costs to manage each fund. The trust funds of the Wisconsin Retirement System account for 91% of funds managed, the State Investment Fund represents 8%, and other funds account for the remaining 1% (including the State Life Insurance Fund, the Local Government Property Insurance Fund, the Patients Compensation Fund, and the State Historical Society Endowment Fund).

Your prompt consideration of this request is greatly appreciated. We will be happy to respond to any questions you may have.

Sincerely,

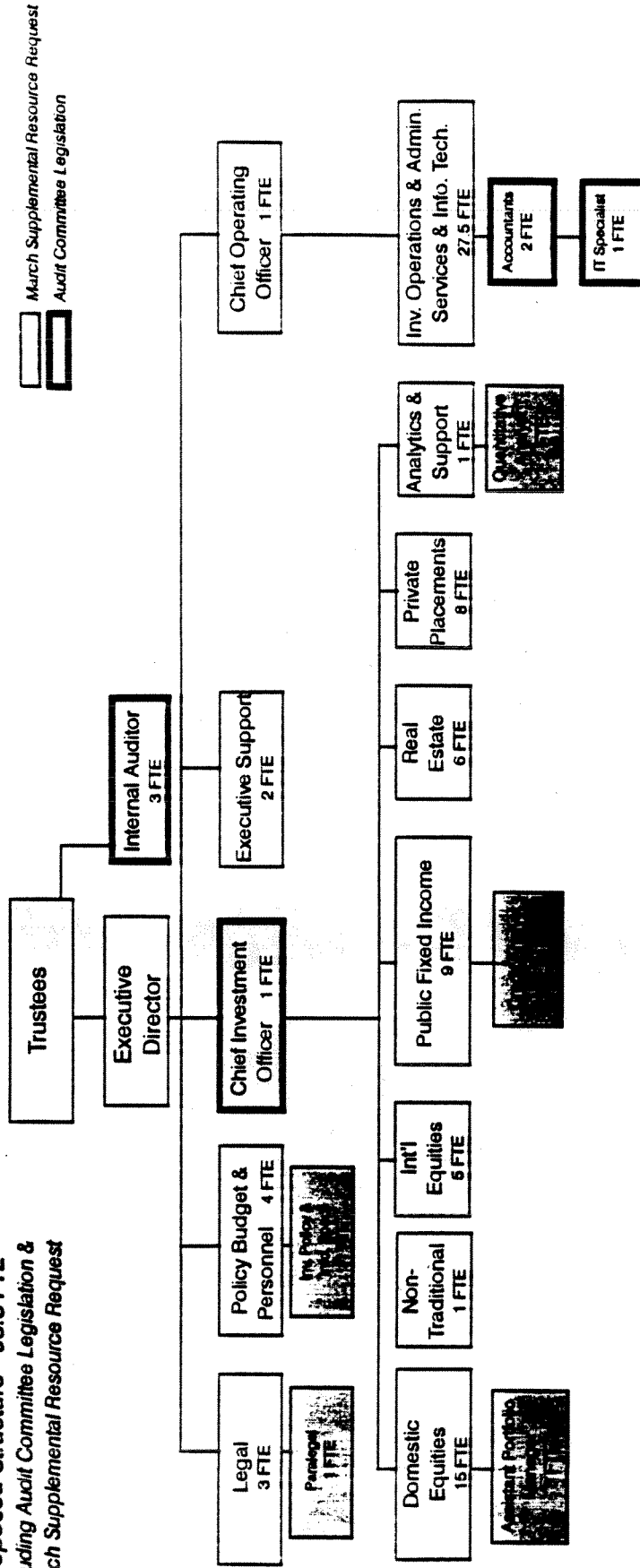


Patricia Lipton
Executive Director

State of Wisconsin Investment Board

Proposed Structure - 98.5 FTE
Including Audit Committee Legislation &
March Supplemental Resource Request

ATTACHMENT A



ATTACHMENT B

State of Wisconsin Investment Board Section 16.505/515 Request

**FY97
Costs**

Assistant Portfolio Managers - Domestic Equities Request 3.0 positions and \$62,200 in FY 96 and \$274,300 in FY 97 to provide an Assistant Portfolio Manager for each of the three domestic equities portfolios. Each portfolio now includes up to \$5 billion in assets. These staff would assist in the development and execution of strategies, and monitor trading activity and price movements. These positions would also provide short-term back-up for the portfolio managers and reduce risk associated with staff departures.	\$274,300
Credit Analyst - Public Fixed Income Request 1.0 Credit Analyst position and \$15,300 in FY 96 and \$58,800 in FY 97 to shorten the credit review cycle from 18 to 12 months and to expand coverage to new companies and industries for bond portfolios.	\$ 58,800
Quantitative Investment and Risk Analyst Request 2.0 Quantitative Risk Analysts and \$30,600 in FY 96 and \$109,600 in FY 97 for the investment analytics group to perform analysis of risk, performance and asset allocation for the Chief Investment Officer.	\$109,600
Investment Policy and Information Specialist Request 1.0 Investment Policy and Information Specialist and \$14,800 in FY 96 and \$50,200 in FY 97 to assist in providing expanded reporting and information to beneficiaries, the Legislature and the public. This position will assume a lead role in the preparation of an expanded Annual Report and other informational materials. The position will also play a lead role in staffing the toll-free information line for participants.	\$ 50,200
Paralegal Request 1.0 Paralegal position and \$13,000 in FY 96 and \$38,700 in FY 97 to support the increased workload associated with minutes and proceedings of new Board and staff committees, outside counsel, and increases in compliance reporting requirements.	\$ 38,700
Grand Total Resource Needs (8 FTE) (FY96 projections assume a May 1, 1996 start date.)	\$531,600

ATTACHMENT C

Domestic Equities Assistant Portfolio Managers 3.0 Positions

Major Responsibilities:

1. Assist in portfolio management by participating in strategy decisions, trading decisions, meetings with companies, and preparation of reports.
2. Assist in monitoring and interpreting market changes as well as world and investment events on a daily basis for potential impact on the portfolio.
3. Perform portfolio analysis across multiple sectors and remain knowledgeable about all portfolio holdings. Identify market trends. Research specific investments to provide buy/sell ideas.
4. Interact with and mentor analytical staff to develop their expertise, prioritize research, and evaluate analysts' recommendations.
5. Provide back-up in the portfolio manager's absence.

Rationale:

The Domestic Equities Group manages three portfolios which each include up to \$5.0 billion in assets. They are currently the largest portfolios managed at SWIB. Each portfolio is now larger than the total assets managed by 85% of the 1,000 largest pension funds in the U.S.

In 1994, the Domestic Equities Group was reorganized to more evenly distribute assets among the portfolios and to provide greater diversification in investment style. These changes also resulted in more effective use of analysts and reduced the need to add staff as assets under management continue to grow. However, further steps should now be taken as part of our overall effort to strengthen risk management.

Unlike other investment areas at SWIB, there are currently no assistant managers for the domestic equities portfolios. This is undesirable from a risk management perspective. In its May 1995 report to the Board on risk management, Price Waterhouse stressed the importance of thorough risk assessment of potential transactions and the need for ongoing monitoring of factors that may impact on the risk profile of a portfolio. The addition of assistant portfolio managers will strengthen SWIB's capabilities in these areas.

Lack of an assistant means that portfolio managers must remain in contact whenever markets are open. On a short-term basis, the risk could be absence of coverage for the portfolio. The longer-term risk is that when a portfolio manager leaves, no one else has been prepared to manage the portfolio, even on an interim basis. This concern was heightened by the recent departure of one of the domestic equities portfolio managers.

The assistant portfolio managers would provide back-up during short-term absences of the portfolio manager. In addition, the assistant managers would ensure that more than one staff member is knowledgeable about holdings in the portfolio. The assistant will also provide a separate perspective on the market. This is desirable from a risk management perspective and should help maximize performance.

Credit Analyst--Public Fixed Income

1.0 Position

Major Responsibilities:

1. Review and analyze markets, capital structure, earnings capacity, corporate strategy and other financial indicators for assigned industries and companies.
2. Forecast financial performance, potential event risk and the relative impact of expected economic developments (both domestic and international) on assigned industries.
3. Prepare in-depth reports incorporating historical information and comparative financial analysis for assigned industries and companies.
4. Identify potential investment opportunities within assigned industries. Recommend appropriate credit quality rating.
5. Modify recommendations to buy, sell or hold as a result of breaking news, company changes, market fluctuations or changing economic conditions.

Rationale:

SWIB currently manages over \$5.2 billion in long-term domestic bonds for the Fixed Retirement Trust Fund. Investments are primarily in U.S. government or corporate bonds purchased in the public sector. Holdings are diversified in terms of credit, maturities and sector.

In its May, 1995 report on risk management, Price Waterhouse noted that best practices in portfolio risk management require that "changes in market factors are regularly monitored and quantified...". As portfolios increase in size, it is increasingly difficult to monitor credit changes, especially during volatile, active markets. Two securities analysts currently perform all credit analysis and due diligence for over 220 companies in 14 industry groups. They also responsible for managing investments for the Patients Compensation Fund (\$329 million) and the State Life Insurance Fund (\$62 million).

The current level of staff is sufficient to perform a credit review of each industry and company every 18 months. This analysis should be conducted more frequently to stay ahead of developments which could affect the risk profile of the portfolio. One additional analyst would enable the credit review to be done once every 12 months. With this greater level of due diligence, the likelihood of identifying a potential change in credit rating is increased, thus raising the potential for added gain (or decreased loss).

For example, based on the average market volatility over the last 20 years, the average spread between an AA rated bond and an A rated bond is 37 basis points (0.37%). A change of one grade in the credit quality of an industrial corporate bond means an average gain/loss of approximately \$1.1 million in market value, based upon an average holding of \$30 million and a yield-to-maturity of 6.99%.

The additional analyst would also enable us to expand the number of market sectors and industries which can be covered. This will provide benefits from a risk management perspective because it would enable the portfolio to be more diversified. Finally, the additional analyst would provide backup to current staff, which is also desirable as a risk management measure.

Quantitative Risk Analysts

2.0 Positions

Major Responsibilities:

1. Participate in the evaluation and implementation of systems which monitor risk characteristics and compare holdings to limits in SWIB's policy guidelines.
2. Monitor aggregate risk exposure and simulate potential risk under different conditions.
3. Assemble, evaluate and report performance measurement and market valuation data at the portfolio and fund levels.
4. Participate in evaluating pricing products and procedures for assets which are not publicly traded and determine their impact on risk management.
5. Assist in the analysis, review and reporting of all performance benchmarks.
6. Assist in the monitoring and readjustment of asset allocation targets. Participate in the annual analysis and presentation of recommendations for allocations of new cash.
7. Monitor asset mix and cash positions for the trust funds. Interact with Employee Trust Fund staff and the consulting actuary to ensure the mutual flow of asset and liability information.

Rationale:

In its May 1995 report on risk management, Price Waterhouse recommended that SWIB expand its capability for measuring and monitoring investment risk. This includes the comparison of portfolio holdings to policy guideline limits, analysis of potential gains and losses under various market conditions, and analysis of performance on a risk adjusted basis.

The Legislative Audit Bureau reached a similar conclusion in its July 1995 report. It suggested that a Chief Investment Officer (CIO), supported by a small staff of analysts, be added to SWIB's staff to improve systems for measuring and reporting risk and to ensure that troubled investments are brought to the attention of senior management and the Trustees in a clear and timely manner.

Legislation developed by the Joint Committee on Audit (SB 402/AB 664) provides the CIO position. However, currently SWIB has only one position to support the CIO and also provide risk measurement, performance monitoring, and asset allocation analysis for over \$40 billion of assets managed in over 20 portfolios in domestic and foreign markets. This staffing level is not sufficient to enable SWIB to develop and implement the measures recommended in the Price Waterhouse and Legislative Audit Bureau reports.

Two additional analysts are needed to: (1) support the CIO in implementing risk controls noted above; (2) provide greater depth of analysis for the various asset allocation, performance measurement and benchmark functions currently performed by only one analyst; (3) and provide backup to the current position on a number of critical tasks involving data collection, verification and analysis.

The Pool Page

My first priority is to ensure that Pool participants are provided with all of the information they require, so they can serve the financial interests of their local constituents.

Welcome

Welcome to our new monthly newsletter. With all of the changes surrounding the Investment Board and the Local Government Investment Pool (LGIP), we thought it would be beneficial to all participants to provide more information in a new and easier to read format. I hope that you like it. This is just another way that the State Treasurer's office is trying to be more responsive to your needs. I, and my staff, welcome suggestions as to topics that should be covered, as well as any other Pool information you feel is necessary. Thank you for your participation in the Pool.

Sincerely,

Jack C. Voight
State Treasurer

The Annual Interest
Rate
for MONTH
X.XX%



Treasurer's Office Begins Testing IVR System

The State Treasurer's office is currently testing an Interactive Voice Response (IVR) System that will allow participants to perform their account transactions via touchtone telephone. In our continuing effort to improve our level of customer service, we hope the new IVR system will help to handle the approximate 100 calls we receive in our office each day. Additional information and materials will be provided shortly. Initially, the system will have 6 incoming lines, so getting a busy signal should be a thing of the past. We will keep you posted.

State Treasurer Continues Annual Conferences for Local Treasurers & Clerks

State Treasurer Jack Voight continued the tradition begun by former Treasurer Cathy Zeuske by holding conferences for local officials in Waukesha and Stevens Point. The

conference attendees were presented information regarding a variety of topics including: the State Trust Fund Loan Program by the Bureau of Public Lands, the Contaminated Land Recycling Program by the Department of Natural Resources, the effects of the budget bill by the Department of Revenue-Bureau of Local Finance, and presentations by the Legislative Audit Bureau, the State of Wisconsin Investment Board and State Senator Peggy Rosenzweig on the issues surrounding the \$95 million loss experienced in March 1995. If you have ideas as to topics for future conferences, please contact Scott Feldt and make him aware of your suggestions.

Reminder

Please review and update your LGIP accounts making sure the proper person is authorized to complete transactions, as well as wire transfer destinations are correct.

The State Treasurer office will be closed for LGIP business on:

December 25th &
December 31st

Happy Holidays!!

Telephone Directory

State Treasurer	
Jack Voight	(608) 266-3712
Deputy Treasurer	
Mike Collins	(608) 266-7982
Executive Assistant	
Scott Feldt	(608) 266-3712
LGIP Administrator	7211
Bonnie Menke	(608) 266- 1248
FAX #	(608) 266-2647
IVR System	(608) 266-1716
LGIP Fund Manager-Investment Bd.	
Jon Traver	(608) 266-2405

LGIP Update

Beginning November 1st, participants can add one additional subaccount. LGIP participants can now have 10 subaccount for use within their account.

State Investment Fund Monthly Summary of Earnings

August 1995

	<u>\$ Amount</u>	<u>% Rate</u>
Average Daily Balance of State Investment Fund	5,137,450.838.81	
Gross Earnings on State Investment Fund	5.995.622.99	5.75
Less: Custodial Bank Charge	(27.338.93)	(0.01)
Investment Board Expense	(99.591.40)	(0.02)
March 1995 Earnings Loss		(0.xx)
Net Monthly Earnings on State Investment Fund	25.828.692.66	5.72

Local Government Investment Pool (LGIP) Monthly Summary of Earnings

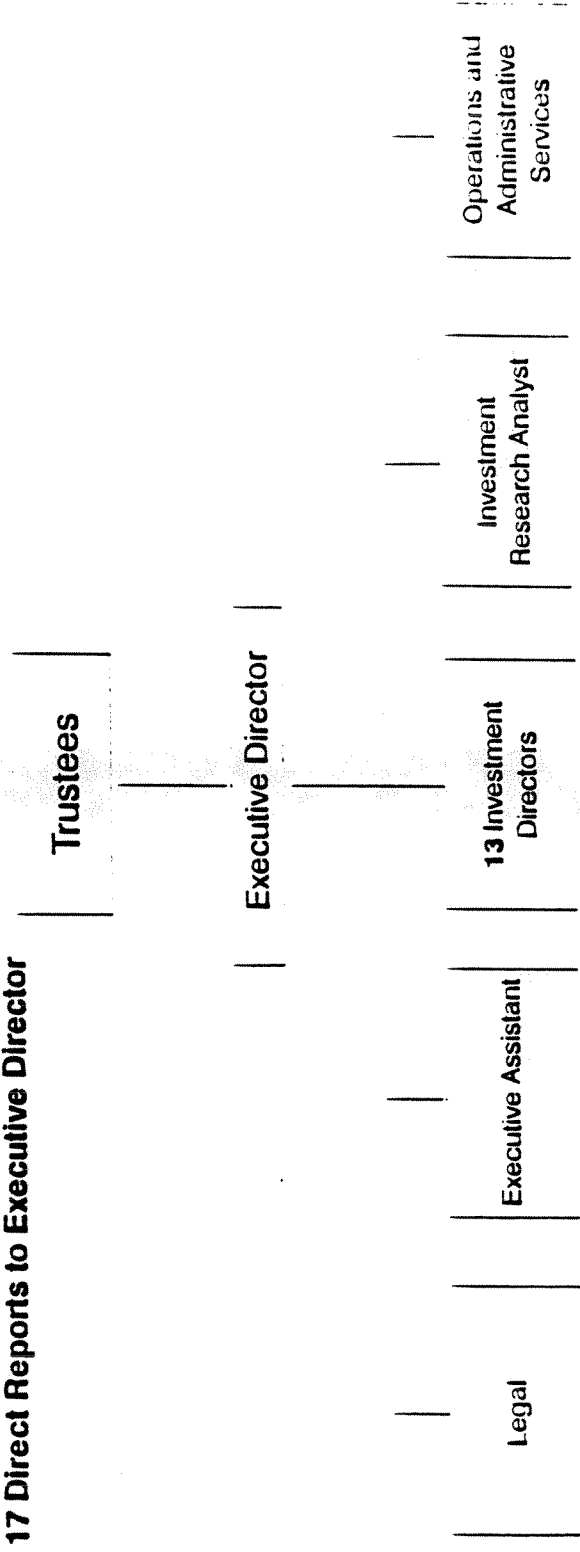
Average Daily Balance of LGIP	2,575.852.523.11	
Gross Earnings on LGIP	12.518.441.09	5.72
Less: DOA Accounting Charges	(7.584.03)	(0.00)
Banking Costs	(5.351.45)	(0.00)
State Treasurer Expense	(13.466.57)	(0.01)
Insurance	(173.720.94)	(0.08)
Net Monthly Earnings on LGIP	12.318.318.10	5.63

<u>Month & Year</u>	<u>LGIP Net Annual Rate</u>	<u>30 Day Treasury Bill</u>	<u>Money Market Checking</u>	<u>Fed Fund Rate MM</u>	<u>All Taxable Funds</u>
Jan 94	3.53	2.78	2.23	2.95	2.70
Feb 94	3.58	2.92	2.27	3.19	2.75
Mar 94	3.72	3.02	2.25	3.25	2.87
Apr 94	3.89	3.39	2.27	3.58	3.06
May 94	4.42	3.62	2.27	3.92	3.36
Jun 94	3.55	3.70	2.31	4.29	3.62
Jul 94	4.12	3.75	2.36	4.26	3.77
Aug 94	4.51	4.04	2.40	4.38	3.96
Sep 94	4.60	4.27	2.32	4.72	4.17
Oct 94	4.80	4.43	2.32	4.80	4.33
Nov 94	4.97	4.70	2.32	5.09	4.63
Dec 94	5.38	4.68	2.32	5.48	5.04
Jan 95	5.55	5.01	2.32	5.38	5.19
Feb 95	5.74	5.15	2.32	5.88	5.44
Mar 95	5.58	5.47	2.30	5.97	5.52
Apr 95	5.62	5.59	2.32	6.08	5.53
May 95	5.97	5.46	2.32	6.01	5.51
Jun 95	5.43	5.31	2.32	6.01	5.48
Jul 95	5.73	5.22	2.32	5.83	5.36
Aug 95	5.63	5.24	2.32	5.75	5.27
Sep 95	5.61	5.23	2.32	5.73	x.xx
Oct 95	x.xx	x.xx	x.xx	x.xx	x.xx
Nov 95	x.xx	x.xx	x.xx	x.xx	x.xx
Dec 95	x.xx	x.xx	x.xx	x.xx	x.xx

ATTACHMENT A

Present Structure

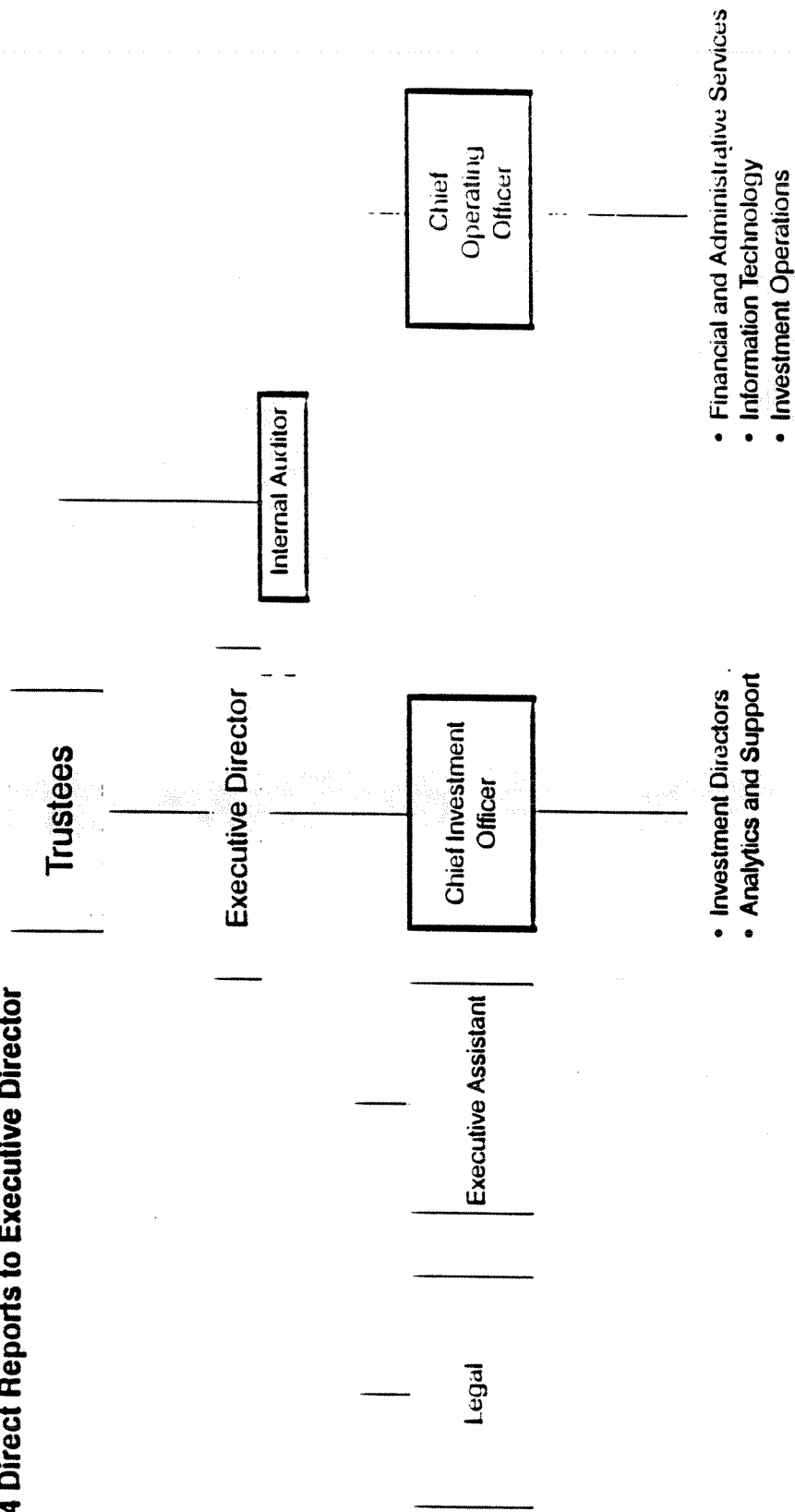
17 Direct Reports to Executive Director



ATTACHMENT B

Proposed Structure

4 Direct Reports to Executive Director



ATTACHMENT C

STATE OF WISCONSIN INVESTMENT BOARD
PORTFOLIO PERFORMANCE WITH BENCHMARKS
PERIODS ENDING 09/30/95
ANNUALIZED RETURNS (%)

	Quarter	One Year	Five Years	Ten Years
Local Government Investment Pool	5.66	5.63	5.30	6.64
IDC/Donoghue Taxable Money Market Funds	5.30	5.33	4.29	5.72
30 Day Treasury Bill	5.25	5.23	4.26	5.19
Money Market Checking	2.32	2.32	3.26	4.36
Fed Funds	5.77	5.79	4.62	6.25

- 72% of Fund in U.S. Government Securities.
- Average maturity 50 days versus IBC/Donoghue at 54 days.
- Short term liquidity (0-3 months) equal to 138% of L.G.P. and 60% of S.H.F.
- 83% of portfolio changes rate in 1 month, 89% in 3 months.
- Market value without derivative and structured note loss equals 100.04% of cost.

ATTACHMENT D

STATE INVESTMENT FUND MONTHLY PORTFOLIO ANALYSIS as of September 30, 1995

	Par Amount \$(000)	Acquisition Yield %	% of Portfolio
U.S. Governments			
Bills	550,000	7.02	
Notes and Bonds	765,000	6.55	
Agencies	556,374	5.57	
Open Repurchase Term Repo	2,268,743	5.46	
Asset Backed	537,491	4.33	
Mortgage Backed Securities	250,497	5.51	
Yankee/Euro	125,000	5.58	
Certificates of Deposit	80,050	5.91	
Bankers Acceptance			
Commercial Paper and Corporate Notes	362,100	6.05	
TOTAL	\$5,005,255	6.06%	100%

SUMMARY OF INVESTMENT FUND PARTICIPANTS

	Par Amount \$(000)	% of Portfolio
State of Wisconsin and Agencies	\$1,822,822	36
State of Wisconsin Investment Board	1,050,892	21
Local Government Investment Pool	2,211,197	43
Total	\$5,084,911	100%

Note: The difference between the total of participants unit shares (\$5,084,911) and the total of the investments (\$5,005,255) is the result of check float (checks written and posted at DQA-Finance that have not cleared the bank) and a timing delay in posting bank receipts at DQA-Finance which have already been invested by SWIB.

AVERAGE MATURITY

9/30/95 - 50 Days

Average Maturity (days) for the last six months.

08/31/95 57	06/30/95 63	04/30/95 80
07/31/95 68	05/31/95 73	03/31/95 76

Note: The Average Maturity calculation takes into account the reset dates of the floating rate securities in the portfolio. The calculation also uses the "average life" maturity date for asset backed and mortgage backed securities.

Definitions

State Investment Fund

This Fund is the combination of cash balances from the State of Wisconsin and its Agencies, the State of Wisconsin Investment Board and the Local Government Investment Pool.

Local Government Investment Pool

This Fund is an aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for the investment and reinvestment by the State of Wisconsin Investment Board.

All Taxable MM Funds

This is an index of all taxable money market funds in the country published by IBC/Donoghue, Inc.

Asset Backed Securities

Securities backed by loans, leases or installment contracts on personal property. The cash flows generated by the underlying assets are used to pay principal and interest to the noteholders.

Bankers Acceptance

A short term negotiable discount note. BAs are drawn on and accepted by banks, which are obliged to pay the face value amount at maturity.

Certificates of Deposit

An interest bearing negotiable time deposit of fixed maturity at a commercial bank.

Commercial Paper

The market name for short-term, unsecured promissory notes that are exempt from registration with the SEC.

Fed Funds Rate

The interest rate charged to banks needing overnight loans to meet reserve requirements by banks with excess reserves at a Federal Reserve District Bank. The rate is set daily through the open market operations of the Federal Reserve.

Money Market Checking

An interest bearing transaction offered by banks.

Mortgage Backed Securities

An ordinary bond backed by an undivided interest in a pool of mortgages or trust deeds. Income from the underlying mortgages is used to pay off the securities.

Repurchase Agreements

The purchase of securities (collateral) from a bank or dealer with the simultaneous commitment by the bank or dealer to repurchase the securities at the same price at some mutually agreed future date at an agreed rate of interest.

U.S. Agencies

An agency chartered by the U.S. Government to serve the public purposes specified by the Congress. Payment of the principal and interest may or may not be guaranteed by the full faith and credit of the U.S. Government itself.

U.S. Treasury Bill

U.S. Treasury short-term discount security.

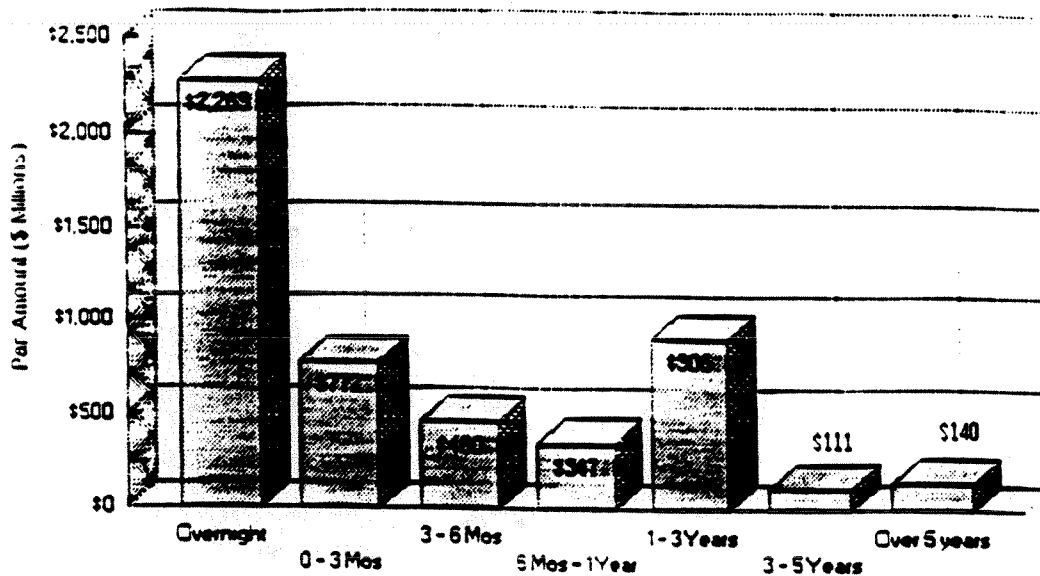
U.S. Treasury Note

U.S. Treasury coupon issues with original maturities up to 10 years.

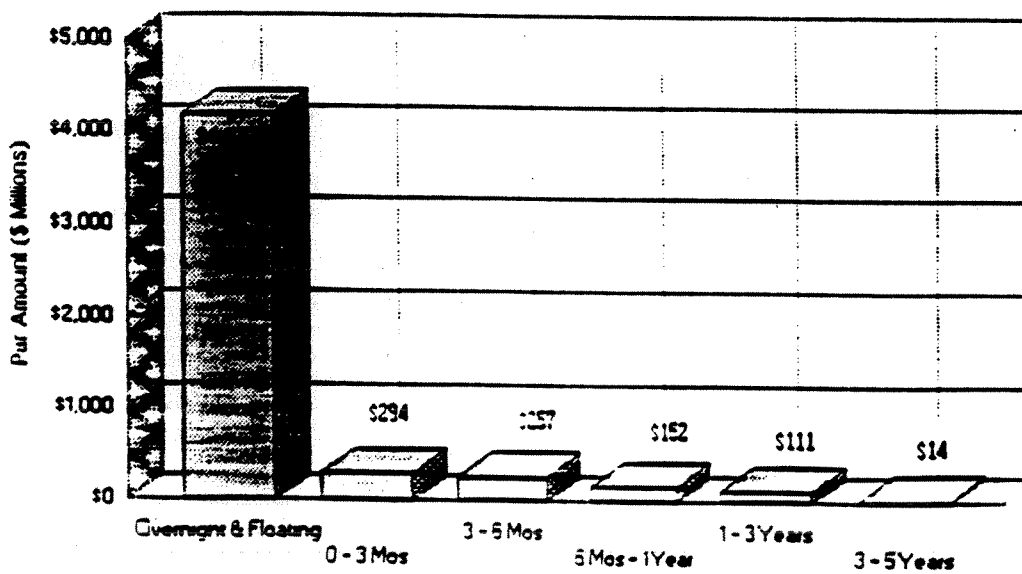
Yankee/Euro

An obligation of a foreign issuer payable in U.S. dollars and registered with the SEC.

Maturity Distribution



Interest Sensitivity



Investment Policy and Information Specialist

1.0 Position

Major Responsibilities

1. Research and respond to inquiries from the Legislature, media and the public regarding SWIB policies and activities. Ensure that information disseminated by the agency is accurate, responsive, and consistent with the policies of the Board.
2. Prepare informational materials for participants in the Wisconsin Retirement System, including newsletter articles, the annual brochure, direct mailings and electronic communications.
3. Assist in the preparation of the monthly newsletter to participants in the Local Government Investment Pool (LGIP).
4. Prepare the narrative portions of the agency's annual report. Work with SWIB staff, auditors and others to ensure that the report is informative, completed in a timely manner, and responsive to various statutory reporting requirements.
5. Operate the toll-free information line for fund participants.
6. Research and evaluate new communications programs or tools to improve the quality and timeliness of information provided to various publics.

Rationale

SWIB currently manages over \$40 billion in assets. Our activities directly affect nearly 400,000 active or retired employees of state and local units of government, some 1,000 local government participants in the LGIP and numerous state agency funds.

An effective risk management program requires that timely and understandable information about investment policies, holdings and performance be provided to participants and the public. It also requires that SWIB staff be accessible on a daily basis to respond to questions from participants, the Legislators and others which have oversight responsibilities.

An additional position is required to meet additional reporting needs and improve our responsiveness as noted by the following:

- SB 402/AB 664 will require that SWIB expand the types of information reported to the Legislature regarding policies, strategies and performance. Our annual financial report will be modified to meet these requirements and to make it more "user friendly." We also plan to publish the report sooner to improve its timeliness.
- We plan to expand, and regularly update, materials provided to participants about the LGIP through a newly-developed manual, and a monthly newsletter produced with the State Treasurer.
- We plan to expand our toll-free information line for fund participants to respond to their questions about investment policies, holdings and performance. To date, this service has been made available only on a limited basis.

Paralegal 1.0 Position

Major Responsibilities:

1. Prepare minutes for meetings of the Board of Trustees, Trustee committees and staff committees.
2. Maintain files for Board and committee activities.
3. Coordinate proxy voting and corporate governance activities.
4. Monitor and report on the use of outside legal counsel.
5. Prepare correspondence and legal documents and provide litigation support for the General Counsel and Assistant General Counsel.
6. Maintain the library for all legal-related manuals, documents, and files.
7. Provide legal assistance for private placements and real estate transactions.
8. Monitor contract compliance.

Rationale:

At present, SWIB's legal staff includes the General Counsel, Assistant General Counsel and one paralegal position. Since the paralegal position was created in 1991, the legal area has experienced a significant increase in workload. Over the last year in particular, additional workload has resulted from heightened emphasis on record keeping and reporting in our effort to strengthen risk management. The overall increase in workload is making it more difficult to meet the agency's basic needs for legal services and has created pressure to rely more heavily on the services of outside counsel.

In 1995, the Board created two new Trustee committees (Audit and Investment Policy) and a staff Risk Management Committee. Legal staff attend and prepare minutes for all Board and committee meetings. In keeping with recommendations of a 1995 Legislative Audit Bureau report, more detailed minutes are now being prepared. For example, minutes for monthly Board meetings have increased from an average of ten pages to 19 pages. Preparation of the minutes now requires the equivalent of .5 FTE.

Over the last five years, SWIB has strengthened its activities as a shareholder in corporate governance matters as part of its fiduciary responsibility. The paralegal coordinates SWIB's shareholder votes with a proxy voting service and responds to questions on proxy matters. The legal workload associated with analyzing issues and proxy voting has increased as the scope of our corporate governance program has expanded and our presence in the markets has grown. This is illustrated by the following data:

- The number of equity investments has increased from 994 in 1991 to 1,125 in 1995;
- The number of shares owned increased from 673 million to 1.0 billion;
- The number of companies on which we are focusing attention because of corporate governance concerns increased from 6 in 1991 to 12 in 1995;
- The number of class action claims in which SWIB participated more than tripled (from 6 in 1991 to 22 in 1995). Federal legislation enacted in December 1995 will result in SWIB taking a more active role in securities class actions as a lead plaintiff, with associated workload demands.

Increased workload is occurring in other areas as well. The number of open records requests increased from 10-15 in 1991 to 15-20 in 1994 and 63 in 1995. Legal review of investment activities has expanded as part of the agency's enhanced risk management activities. This includes review of compliance reports to the Securities and Exchange Commission, assumption of state ethics monitoring duties and responsibility for ongoing distribution to third parties of signature authority.

The amount of legal work being handled by outside counsel because of insufficient paralegal staff has increased from about 60 billed hours in 1991 to 120 billed hours in 1995, at an increased cost to the agency. In addition, we have had to delay efforts to improve oversight of transactions handled by outside counsel. This has impeded SWIB's ability to standardize legal documents and file organization across investments, reducing efficiency of outside counsel and agency staff. With the addition of a paralegal, approximately 10% of the General Counsel and 10% of the Assistant General Counsel's time would be freed to handle legal responsibilities internally.

Without the addition of a second paralegal position, there will likely gaps and delays in legal compliance, some work would simply not be performed, and there would be an increased dependence and cost associated with outside counsel. This could result in additional investment risk and ethics risks as well as compliance problems and missed financial recoveries from class actions.

Paralegal Annual Workload:

1000 hours	Minute preparation
600 hours	Proxy voting and corporate governance
1900 hours	Class actions, open records, record and file-keeping, transaction monitoring
600 hours	Contract reporting

4100 hours = 2 FTE

FAUSER\UOHNSKW\WORDPROC\16505\REQUEST\February 26, 1996

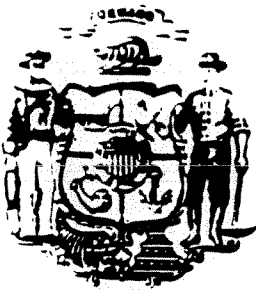
ATTACHMENT D

State of Wisconsin Investment Board
Assets Under Management and Operating Expenses
Includes 7.0 FTE from Audit Legislation and 8.0 FTE under Section 16.505/515 risk management needs

Fiscal Year	Assets Under Management		Actual Operating Expenditures		
	At Year End	Average Assets Over Year	Amount	Basis Points (e)	Positions
1984	\$10,014,913,000	\$9,344,413,000	\$1,821,354	1.949	45 0
1985	12,346,979,000	11,180,946,000	2,072,706	1.854	52 0
1986	15,250,647,000	13,798,813,000	2,837,093	2.056	54 0
1987	17,978,744,000	16,614,695,500	2,927,886	1.762	57 0
1988	18,239,473,000	18,109,108,500	3,200,018	1.767	59 0
1989 (a)	21,123,360,000	19,681,416,500	4,266,600	2.168	63 0
1990	23,380,847,000	22,252,103,500	5,591,300	2.513	65 0
1991	25,680,415,000	24,530,631,000	5,533,300	2.256	65 0
1992	29,186,270,000	27,433,342,500	5,859,800	2.136	74 5
1993	33,334,618,000	31,260,444,000	6,194,500	1.982	74 5
1994	34,469,000,000	33,901,809,000	6,926,903	2.043	78 5
1995	37,809,000,000	36,139,000,000	7,465,451	2.066	79 5
1996	42,700,000,000 (b)	40,254,500,000	8,186,300 (c)	2.034	98 5
1997	45,902,500,000 (b)	44,301,250,000	8,996,500 (d)	2.031	98 5
% Change					
1984 to 1997	358.3%	374.1%	393.9%	4.2%	118.9%

NOTES:

- (a) First Full Year of Management flexibility
- (b) Estimated growth in assets
- (c) Estimated expenditures based upon budget authority plus the impact of 3 months of Audit Committee Legislation and 2 months of Section 16.505/515 resource needs in FY96.
- (d) Estimated expenditures based upon budget authority plus the impact of 12 months of Audit Committee Legislation and 12 months of Section 16.505/515 resource needs in FY97.
- (e) "Average Assets" are used to compute basis points



ATTACHMENT E

STATE OF WISCONSIN INVESTMENT BOARD

MAILING ADDRESS:
P.O. BOX 7842
MADISON, WI 53707

121 EAST WILSON ST.
MADISON, WI 53702
(608) 266-2381

December 22, 1995

HAND DELIVERED

Senator Peggy Rosenzweig
PO Box 7882
State Capitol
Madison, WI 53707-7882

Representative Mary Lazich
PO Box 8952
State Capitol
Madison, WI 53708-8952

Dear Senator Rosenzweig and Representative Lazich:

The July 1995 report by the Legislative Audit Bureau (LAB) recommended that we report to the Joint Committee on Audit by December 31 regarding our future plans to enhance oversight of investment activities. The LAB also recommended that we report on our plans to provide additional information to participants in the local government investment pool (LGIP) and that we address alternative methods for insuring the LGIP.

This report is being submitted as recommended by the LAB. We plan to update you as we proceed to implement measures described in the report.

Introduction

Over the last nine months, SWIB Trustees and staff have focused a great deal of additional attention on the policies, organizational structure and resources which are necessary to effectively manage risk and earn favorable rates of return for fund participants. In three public hearings before the Joint Committee on Audit, we discussed actions which SWIB has taken or planned. The Board has expressed support for Senate Bill 402 and Assembly Bill 664, the companion bills developed by the Committee relating to the LAB reports. While there are some changes which the Board continues to seek, the bills take a constructive approach and address important resource needs in several areas.

We appreciate your willingness to provide additional staff and funding for a number of risk management needs. You have suggested that resources beyond what is currently provided in SB 402 and AB 664 should be requested through the Joint Committee on Finance. We plan to submit a ss. 16.505/515 request for consideration at the Committee's next quarterly meeting in March 1996. As a related matter, the Finance Committee has deferred consideration of our request to release funds for the 1995 and 1996 performance bonus until March. After reviewing the August 1995 LAB report on the bonus, the Audit Committee supported continuation of the program. It is essential that we be able to recognize staff who have added to the performance of the funds we manage. Your support for our request is very important.

I want to extend my thanks to you, other members of the Joint Committee on Audit, and the Legislative Audit Bureau for your willingness to work with us on these matters. I believe the discussions we have had over the past several months with you and with fund participants have been helpful in strengthening communications and fostering a greater understanding of the challenges which SWIB is addressing.

Oversight of Investment Activities

The July 1995 LAB report included the following recommendations:

"We recommend that the State of Wisconsin Investment Board examine the feasibility and costs of future plans to increase oversight of investment activities and specifically address:

- 1. Development of comprehensive investment guidelines, as well as procedures for periodic update of the guidelines, that establish limits for allowable investments, investment strategies, and risk levels;*
- 2. Adoption and implementation of methodologies for measuring and evaluating risks in individual investments across portfolios;*
- 3. Development of a strategic information systems plan that includes intermediary stages and a timetable for addressing the Investment Board's reporting needs; and*
- 4. Organizational changes the Investment Board is pursuing to provide the necessary oversight of investment activities.*

We further recommend that the State of Wisconsin Investment Board report its conclusions to the Joint Legislative Audit Committee by December 31, 1995."

The following portions of this report address each of the four areas noted by the LAB.

1. Investment Guidelines

Investment guidelines for each portfolio delegate authority to staff to make investments within constraints that recognize the purposes and objectives of each fund under management. Modifications to the guidelines are periodically considered by the Trustees as markets change and evolve. A major update of the guidelines for the Real Estate Division was approved in 1994. Extensive revisions to the guidelines for the Private Placements Division were proposed by staff earlier this year and are under review by the Trustees.

Over the last nine months, the Board has taken the following added steps to review the guidelines from a risk management perspective:

- An Investment Policy Committee of Trustees has been established to examine and oversee SWIB investment policies, including the guidelines for each portfolio.
- Revised guidelines have been approved by the Trustees to limit the use of derivatives to only those instruments which reduce or otherwise hedge risk. The delegation of authority to portfolio managers to enter into derivative investments has been removed. All derivative transactions must be approved by a committee of senior staff.
- Guidelines for the State Investment Fund (SIF) have been rewritten to clarify fund objectives, asset allocation limits and credit quality restrictions. The revised guidelines conform with statutory constraints established in SB 402/AB 664. The new guidelines have been approved by the Trustees and have been provided to LGIP participant groups for review.
- A staff committee has completed a review of risk definitions in the guidelines for each portfolio. Their recommendations will be reviewed by the Investment Policy Committee, which will in turn make recommendations to the full Board. I anticipate that this review will begin in January 1996 and will be completed by mid-year.
- One of the responsibilities of the staff Risk Management Committee will be to review the guidelines on a periodic basis. Under SB 402/AB 664, the Board would be required to notify appropriate legislative committees upon adoption of any change to our investment policies or guidelines.

2. Measurement and Evaluation of Risk

As noted in our response to the July 1995 LAB report, risk management is the major challenge which preoccupies most large investment management organizations today. A comprehensive evaluation of risk requires an understanding of the types of investment risk and systems for measuring risk on an aggregated basis across portfolios. Information should be communicated to Trustees, beneficiaries and the Legislature that is readily understandable and useful for quickly grasping where risk is being taken, why it is being taken and how it is being managed.

We have taken the following actions to strengthen oversight and reporting of investment risk:

- All derivative investments are marked to market on a monthly basis. Valuations are being independently confirmed by outside sources. The position of each derivative investment is being

monitored on an ongoing basis by a staff committee. A monthly report is being prepared which tracks the position of derivative investments.

- A quarterly report is being provided to the Trustees which highlights risk at the portfolio and fund levels associated with currency, liquidity, interest rates, market concentration and other factors.
- We plan to reallocate an existing vacant position to create the position of chief operating officer with lead responsibility for the upgrade and oversight of risk management information systems, controls and reporting.
- We are in the process of selecting an outside consultant to assist us in developing a long-range strategic information systems plan (discussed below). The plan will define the technology necessary to address information needs for risk management, measurement and control. This project, or a separate project, will address specific analytic systems and software products needed to meet future risk measurement needs. We anticipate that this work will be completed in 1996.
- Under SB 402/AB 664, we would report annually to the Joint Committee on Audit and appropriate standing committees on a number of items, including risks associated with investment holdings.

3. Strategic Information Systems Plan

SWIB currently manages assets of nearly \$40 billion in more than 2,300 separate investments. The management of these investments depends upon the timely exchange and analysis of tremendous amounts of information. We utilize over 25 separate electronic information sources to make investment decisions. We rely on an extensive information systems to process over 1,800 transactions per month through our custodial banks and our internal accounting system.

Since 1992, we have been moving much of our financial systems support to our custodial banks rather than continue to rely on increasingly expensive internal information systems. Although this has contained costs, it has not always resulted in the level of flexibility needed as markets and operations needs change. In 1994, we met with a number of widely recognized investment organizations to compare management practices. This effort confirmed that we have been operating with far fewer resources in support of information technology than is the case for other organizations which actively manage investments. The May 1995 report by Price Waterhouse to the Board drew further attention to the agency's information technology needs.

SWIB requested and received two additional positions in the 1995-97 biennial budget to provide basic applications support and training to investment staff. However, the resources required to develop and implement a comprehensive, long-range plan go beyond what can be provided by our current staff level.

Our long term goal is a centrally integrated data base that links critical data from systems which are currently independent. Enhancements to information systems will need to be evaluated from a cost/benefit perspective. Accordingly, the following steps are in progress with regard to a strategic information systems plan:

- In November, we issued a request for proposals (RFP) from major consulting firms to assist us in developing a long-term strategic information systems plan which will place heavy emphasis on risk management capabilities. The RFP was reviewed by information technology staff in the Department of Administration. We are reviewing the responses to the RFP and hope to have the selection process completed in early 1996.
- One additional position is provided in SB 402/AB 664 to assist with the workload associated with preparing the strategic information systems plan with the consultant. Upon completion of the plan, this position will be used to help with implementation.
- Our goal is to complete the planning before the fall of 1996 in order to incorporate the resources we will need to implement system improvements in our 1997-99 biennial budget request.

4. Organizational and Oversight Changes

In our response to the LAB report, I indicated in July that additional resources and organizational improvements are necessary at senior levels of SWIB because of our growing size and the increasing complexity of our activities. We have developed a staffing plan which defines and addresses these needs. In addition, the Trustees have made changes in the Board's committee structure to enable them to focus greater attention on risk management matters. The following organizational changes have been made or are planned:

Board of Trustees. The Trustees have created two new committees of the Board:

- Investment Policy Committee. This committee will examine and oversee long-term investment strategy for risk management, investment policies, and implementation of investment procedures.
- Audit Committee. This committee is developing policies and procedures for the internal audit function. They are being assisted in this effort by the State Controller and State

Auditor. The Audit Committee will provide ongoing review and direct oversight of the internal auditor and will, at least annually, review audit policies and procedures.

Senior Management. The Trustees have approved a plan which incorporates the following additional senior management positions. The current (ATTACHMENT A) and proposed (ATTACHMENT B) organizational plans are attached.

- **Chief Investment Officer.** This position will report to the Executive Director and: (1) have lead responsibility for development and execution of investment strategy; (2) provide management oversight of the investment directors; (3) manage the peer review process; and (4) work with the chief operating officer on risk-related matters. Authority and funding for this position is provided in SB 402/AB 664, beginning in the current fiscal year.
- **Chief Operating Officer.** This position will report to the Executive Director and have: (1) lead responsibility for implementation of risk management systems; (2) oversight of information technology planning and functions; (3) oversight of investment operations and custodial banking relationships. As noted previously, we are planning to reallocate a currently vacant position and hope to have the chief operating officer on staff before the end of the current fiscal year.
- **Internal Auditor.** This position will report to the Audit Committee of Trustees and: (1) develop and maintain an internal audit plan; (2) coordinate and provide assistance with external audits and reviews, including risk assessment and performance measurement; and (3) review activities of outside investment managers and custodial banks. Authority and funding for 3.0 positions are provided in SB 402/AB 664, beginning in the current fiscal year.

Investment Operations and Information Technology. We have identified the need for three additional positions in these areas to strengthen risk management measures. Authorization and funding is provided for these positions in SB 402/AB 664:

- **Investment Accountants.** Two new professional accountant positions will provide additional oversight of investment transactions and assist with the preparation of expanded financial statements and reports.
- **Information Technology Specialist.** As noted previously, this position will help manage additional workload associated with preparation of the strategic information systems plan and will help implement system enhancements when the plan is completed.

Derivatives/Risk Management Committee. We established a Derivatives Committee of senior SWIB staff to review and approve our use of these instruments. The role of this committee

has been expanded to a Risk Management Committee whose primary responsibilities are to review: (1) the allocation of assets to different categories of investments; (2) all new investment initiatives before presentation to the Trustees; and (3) all portfolios on a quarterly basis.

Investment and Support Staff. The Joint Committee on Audit has affirmed that SWIB should continue to emphasize internal management of investments. In keeping with that preference, we undertook a comprehensive assessment of immediate and longer term staffing needs in each of our investment and support areas. This work was completed in early December and is being reviewed with the Trustees. Your November 30 letter to the Board indicated that you were not comfortable adding resources to SB 402/AB 664 beyond what the bills currently provide. At the suggestion of the Co-Chairs of the Joint Committee on Finance, we plan to present these needs in a ss. 16.505/515 request for consideration at the Finance Committee's quarterly meeting in March 1996. Some needs will be addressed in our 1997-99 biennial budget request.

State Investment Fund—Communications

The July 1995 report from the LAB included the following recommendation regarding information provided to local government participants in the State Investment Fund (SIF).

"We recommend that the State of Wisconsin Investment Board work with investors in the Local Government Investments Pool to determine the appropriate content and frequency of additional information to be distributed to participants in the Fund, and report its plan for providing more information to the Joint Legislative Audit Committee by December 31, 1995."

Over the last nine months, we have held over 40 meetings around the state with local officials to discuss the derivatives-related loss in March. We solicited their input regarding the types of information they would like to receive and how often they would like to receive it.

With the assistance of local government associations and the State Treasurer, we have held six focus groups for the purpose of: (1) reviewing the recently revised SIF guidelines; (2) soliciting reaction to a planned expansion of the monthly earnings report; and (3) reviewing participants' preferences for credit insurance. Focus groups have been held through the following associations:

Wisconsin Technical College System Business Officers
Wisconsin County Treasurers
Wisconsin Towns Association
Municipal Treasurers Association
Wisconsin Association of School Business Officers (K-12)
Wisconsin Government Finance Officers

With their input, the following enhancements are being made in our communications:

- Quicker distribution of monthly earnings information to participants is being done with the assistance of DOA and the State Treasurer's office. In most months, this should occur within five to seven working days, reducing the amount of time previously required by half. Participants have reacted favorably to this change. SB 402/AB 664 would direct SWIB to make all reasonable efforts to provide information in time for the State Treasurer to notify participants within six working days. We are making every effort to meet this objective.
- The State Treasurer has developed an expanded monthly earnings report and newsletter to be distributed beginning early in 1996. Based on feedback we have received from participants, we plan to include an expanded monthly statement of earnings, with additional information on the maturity and interest rate sensitivity of the portfolio. The State Treasurer plans to include information highlighting new procedures and important dates (ATTACHMENT C).
- The monthly earnings report will continue to include comparisons of LGIP earnings rates with comparable investment alternatives. We are also planning to provide a quarterly performance report covering the preceding one-, five- and ten-year periods compared with appropriate indices or benchmark. This would go beyond what is required in SB 402/AB 664 (ATTACHMENT D).
- We are producing a monthly report that compares the market value of our holdings to cost. This report is available to participants upon request and will be distributed at least annually to all participants (ATTACHMENT E).
- Revised investment guidelines have been approved by the Trustees and provided to participant groups for their reaction. The new guidelines provide a clearer description of policies regarding asset allocation, credit quality, maturity, issuer exposure and derivatives authority (ATTACHMENT F). The revised guidelines are consistent with statutory limitations contained in SB 402/AB 664. Under the legislation, we will annually provide a copy to participants upon request, and at least annually to all investors.
- We are developing a policies and procedures manual to be provided to each LGIP participants that can be readily updated as needed. This plan has been enthusiastically received by LGIP participants.
- An expanded ongoing emphasis on communications with participants will continue as a result of the designation of an additional investment staff professional for SIF. This will enable the investment director to continue with local meetings and discussions on a regular basis.
- Under SB 402/AB 664, the Board would be expanded to include an additional Trustee representing a local government participating in the LGIP.

State Investment Fund—Credit Insurance

Since 1989, SWIB has contracted with a private company to insure deposits in the LGIP in the event of loss of principal resulting from default. The decision to provide insurance contributed to an increase in investor confidence and a significant growth in LGIP deposits, beginning in 1989. However, in its July 1995 report, the LAB questioned whether the benefits of the current coverage justify the costs. Their report made the following recommendation:

"We recommend that the State of Wisconsin Investment Board investigate alternative methods for insuring the Local Government investment Pool and report its results and recommendations for change to the Joint Legislative Audit Committee by December 31, 1995."

This recommendation was also included SB 402/AB 664, which directs SWIB to provide the report within two months after passage of the bill.

We agree that the current coverage needs to be reexamined. At this time, there are several basic alternatives which we are discussing with LGIP participants and the State Treasurer:

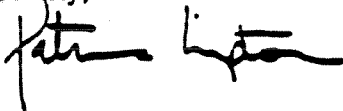
- ◆ Purchase different coverage. We have discussed other types of private insurance coverage that might be purchased through the current provider or from other parties who have expressed interest in offering coverage. We have consulted with DOA risk management staff in this effort. It appears possible to secure coverage on better terms than the LGIP currently receives, but questions raised by the LAB and others about the merits of insurance coverage may still remain.
- ◆ Operate with no insurance. The LGIP has never incurred a credit loss. A number of participants have expressed a preference for eliminating the insurance so long as the LGIP operates within appropriate guidelines and adequate internal controls. Eliminating the insurance would result in an annual savings of \$3.2 million in premium costs to LGIP participants. However, some participants have expressed reluctance to eliminate insurance coverage because of concerns that their auditors may raise.
- ◆ Self-Insurance. Many participants have expressed interest in an approach under which a self-insurance fund would gradually be built up over time from the amounts that would otherwise be paid to purchase coverage from a private provider. The key issue with this approach is that it would take a number of years before the fund grew to sufficient size to provide meaningful coverage. Some other interim coverage may be required to bridge between the current coverage and self-insurance. Statutory changes would likely be necessary to implement a self-insurance program.

Senator Rosenzweig
Representative Lazich
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Our plan is to further discuss these issues with local governments, auditors and others and to more fully define the advantages and disadvantages of these alternatives. We hope to have this process completed within the next 60 days.

I hope this report conveys the significant attention that Trustees and staff are giving to these matters and the progress that is being made. I would welcome and comments or questions you may have. Please feel free to contact me.

Sincerely,



Patricia Lipton
Executive Director

cc: Members, Joint Committee on Audit
Members, Joint Committee on Finance
State Treasurer
Dale Cattanaich